

Internal Revenue Service
memorandum

CC:TL
Br4:CRGilbert

date: 30 DEC 1987

to: District Counsel, Indianapolis C:IND

from: Acting Director, Tax Litigation Division CC:TL

subject: [REDACTED] - Withholding of Non-Resident
Alien Income and Statute Extension Under I.R.C. § 6501(e)
Your Reference: C:IND:TL-N-8636-87: RMHuey-jb

This is in reply to your memorandum dated October 6, 1987, in which you requested technical advice in regard to whether the assessment period for withholding of non-resident alien income, prescribed by I.R.C. § 1441 1/ and reported on Form 1042, may be extended to six years, pursuant to I.R.C. § 6501(e). Our reply is based on the holding of a drafted O.M. which will be forwarded to you upon its issue.

ISSUE

Whether the six-year period of limitation on assessment imposed by I.R.C. § 6501(e) applies to the withholding tax liability of a domestic, parent corporation that omits from its Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, an amount of interest paid to a foreign, subsidiary corporation which exceeds 25 percent of the amount of gross income stated in the return.

FACTS

The taxpayer, [REDACTED] ([REDACTED]), established a Netherlands-Antilles corporation which issued some \$[REDACTED] in bonds at [REDACTED] percent interest. The Netherlands-Antilles corporation then loaned the proceeds to the

1/ I.R.C. § 1441 requires all persons paying items constituting gross income from sources within the United States, to any nonresident alien individuals, to deduct and withhold from such items a tax equal to 30 percent thereof.

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taxpayer at [REDACTED] percent interest, subject to no collateral. The taxpayer subsequently failed to withhold and deduct from the resulting interest payments the tax owed by its foreign, subsidiary corporation, as required by I.R.C. §§ 1442 and 1461.^{2/} Nevertheless, the taxpayer filed a Form 1042 that properly reported and withheld the tax due on other transactions involving income amounts paid to nonresident aliens. As a result of its omission of the interest paid to the Netherlands-Antilles corporation, the taxpayer understated its withholding tax liability by approximately \$ [REDACTED] (representing the [REDACTED] percent withholding tax multiplied by the approximately \$ [REDACTED] interest paid by [REDACTED] to the Netherlands-Antilles corporation). The amount of interest paid by the taxpayer and omitted from the Form 1042 exceeded [REDACTED] percent of the amount of gross income stated in the return.

The subject case is currently non-docketed and the normal three-year assessment period has expired with respect to the taxpayer's withholding tax liability for the tax year in issue. The Indianapolis District Counsel, in an October 6, 1987, memorandum, requested technical advice with respect to whether the assessment period for the withholding of tax on nonresident alien income could be extended to six years pursuant to section 6501(e).

DISCUSSION

We are of the opinion that the six year period of limitation on assessment pursuant to I.R.C. § 6501(e) does not apply in this situation because the gross income requirement of that section is not met. I.R.C. § 6501(e) requires that a taxpayer omit from its gross income an amount properly includible therein which exceeds 25 percent of the amount of gross income stated in its return. The taxpayer herein omitted reporting and withholding an amount of gross income paid to another person, and, for that reason, the statute is not satisfied. In other words, we believe that the understatement of gross income required under I.R.C. § 6501(e) regards a taxpayer's tax liability for its own gross income under I.R.C. § 11, rather than a withholding agent's liability under I.R.C. §§ 1442 and 1461.

^{2/} I.R.C. § 1442 is analogous to I.R.C. § 1441, and applies in the case of payments to foreign corporations. I.R.C. § 1461 imposes liability for the withheld tax on the person required to withhold and deduct such tax, i.e. the withholding agent.

The proposed O.M. recognizes the distinction between a taxpayer's income tax liability and a withholding agent's liability, and notes that in S-K Liquidating Co. v. Commissioner, 64 T.C. 713 (1975), the Tax Court held that although the withholding tax liability imposed by I.R.C. §§ 1441 and 1461 is an "income tax" under chapter 3 (Withholding of Tax on Nonresident Aliens, etc.) of subtitle A (Income Tax) of the Code, the two taxes are distinctly different, stating:

Though both taxes are imposed under the income tax subtitle of title 26, one tax is on the income of petitioner, and the other is on the disbursements to another (the nonresident alien taxpayer), and, as in the case of transferee liability where the petitioner is liable for the tax of another, respondent and petitioner are each entitled to a separate day in court with respect to each of the two taxes.

64 T.C. at 718 (Emphasis added).

In Rev. Rul. 75-552, 1975-2 CB 476, the Service followed the Tax Court's decision in S-K Liquidating Co. and concluded that the 30 percent withholding tax imposed by I.R.C. § 1441 (or I.R.C. § 1442 here) is a separate and distinct tax from the income tax imposed by I.R.C. § 11. Furthermore, in Section 6661 Penalty in Form 1042 Examinations, GCM 39686, I-203-87 (Dec. 11, 1987), it was noted that the withholding tax is not an "income tax" on the withholding agent within the meaning of the term for United States tax purposes, since the withholding tax is not imposed on the withholding agent's own income but, rather, on the disbursements of income that belong to another person (the nonresident alien). GCM 39686 at 5-7.

The position that I.R.C. § 6501(e) applies where a taxpayer makes an omission from its own gross income is also supported by the section's legislative history. See Pub. L. No. 216, § 275(c), 73d Cong., 2d Sess. (1934). Specifically, the Senate Report that accompanied section 275(c) stated:

The House bill continues this policy, but enlarges the scope of this provision to include cases wherein the taxpayer understates gross income on his return by an amount which is in excess of 25 percent of the gross income stated in the return.

S. Rep. No. 558, 73d Cong., 2d Sess. 43-44 (1934) (Emphasis added).

The Senate Report included two examples, namely, improper reporting of dividends and improper year of inclusion, which illustrated that the gross income requirement of section 275(c) concerned a taxpayer's reporting of its own gross income and not items of gross income paid to another, that is, items received as opposed to items disbursed by the taxpayer.

We also note that I.R.C. § 6501(e) does not apply in this situation because I.R.C. § 6501(e)(1)(A)(i) defines "gross income", in the case of a trade or business, to mean "the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services." Although a Form 1042 does not provide for the amounts received or accrued from the sale of goods or services by a taxpayer, the import of this definition is that the statute contemplates an omission from the taxpayer's own gross income. Since a withholding agent would not be in a position to reduce the gross income of another person by the cost of such goods or services sold, the definition would have no application to chapter 3 withholding on a foreign corporation's income. Thus, the "gross income" definition of I.R.C. § 6501(e)(1)(A)(i) must only refer to the taxpayer's own gross income.

Two possible alternatives that may remedy this situation were discussed informally with the Interpretative Division. These alternatives are merely suggested and may not apply here.

First, pursuant to Treasury Regulation § 1.6012-2(g)(2), a foreign corporation which at no time during the tax year is engaged in a trade or business in the United States is not required to file a return for the tax year if its tax liability for the year is fully satisfied by the withholding of tax at the source. If that requirement is not met, however, a return must be filed. In the present case, that requirement has not been met, and it appears that the foreign, subsidiary corporation has not filed a return for the involved tax year. Thus, in accord with I.R.C. § 6501, since the foreign, subsidiary corporation has apparently not filed its required return, the applicable period of limitation is probably open. We suggest that you consider the possibility of issuing a statutory notice of deficiency directly to the foreign, subsidiary corporation.


Second, if the taxpayer fraudulently omitted from its Form 1042 the interest paid to its foreign, subsidiary corporation, the statute of limitations will not have expired. See I.R.C. § 6501(c)(1). We are aware of no facts supporting a conclusion that the omission was fraudulent; however, since related parties are involved, we suggest that you consider investigating this possibility.

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If you have any questions about this matter, please contact
Craig R. Gilbert at FTS 566-3305.

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By:


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Enclosure:
GCM 39686